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Ratings

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Summary:

South San Francisco Public Facilities Financing Authority
South San Francisco; Appropriations; General Obligation

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Credit Profile		
US$70.6 mil lse rev bnds (South San Francisco) ser 2022A dtd 06/02/2022 due 06/30/2046		
Long Term Rating	AA+/Stable	New
South San Francisco ICR		
Long Term Rating	AAA/Stable	Affirmed
South San Francisco Pub Facs Fin Auth, California		
South San Francisco, California		
South San Francisco Pub Facs Fin Auth (South San Francisco) lse rev bnds		
Long Term Rating	AA+/Stable	Affirmed
South San Francisco Pub Facs Fin Auth (South San Francisco) lse rev bnds		
Long Term Rating	AA+/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA+' long-term rating to the City of South San Francisco Public Facilities Financing Authority's expected $70.6 million series 2022A lease revenue bonds, which are an obligation of South San Francisco. At the same time, S&P Global Ratings affirmed its 'AAA' issuer credit rating (ICR) on the city and its 'AA+' long-term rating on the authority's previously issued appropriation obligations. The outlook is stable.

The ICR reflects our forward-looking opinion of South San Francisco's overall creditworthiness, focusing on the city's capacity and willingness to meet its financial commitments as they come due. The ICR is not specific to any financial obligation.

Payments by the city, as lessee, secure the series 2022A and its previously issued lease revenue bonds. We have set our rating on these obligations one notch below our view of the city's general creditworthiness to reflect our view of appropriation risk. Lease payments, for which the city has covenanted to budget and appropriate over the life of each appropriation series, are subject to abatement, but South San Francisco has agreed to maintain 24 months of rental interruption insurance to partly mitigate abatement risk, and the leased assets meet our criteria for seismic risk during the life of each series.

Proceeds from the bonds will finance the acquisition and improvements to the city's owned Orange Memorial Park and pay costs incurred to connection of the issuance.

The city is eligible to be rated above the sovereign because we believe the city can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign," published Nov. 19, 2013, on RatingsDirect, U.S. state and local governments are considered moderately sensitive to country risk.

Credit overview

South San Francisco's credit profile reflects our view of a very strong economy demonstrated by a decade of positive operating results prior to the pandemic. However, the city's businesses focusing on business travel have suffered from a plunge in demand, and the city has seen losses in lodging tax revenue to match, with management expecting only the beginnings of a recovery for fiscal 2022. The city finished two of the past three audited years with positive operating results but finished fiscal 2021 with a large total governmental fund deficit as a result of the pandemic affecting core revenue streams and planned capital outlay expenditures. Property tax revenue has continued to grow throughout the pandemic, and sales tax revenue, the city's second-largest revenue stream, has exceeded pre-pandemic levels. However, transient occupancy tax revenue has yet to recover from the pandemic and we believe that the city's transient occupancy revenue will not recover within our credit horizon. We expect the city's good financial management policies and receipt of one-time state and federal stimulus funding to result in at least balanced operations by fiscal 2023.

The rating further reflects our opinion of the city's:

- Very strong local economy, which centers on the biotechnology industry and offers employment opportunities throughout the San Francisco Bay area;
- Positive operating results the past decade and maintenance of strong-to-very-strong general fund reserves and very strong liquidity;
- Strong management, with good financial policies and practices under our financial management assessment methodology that are reviewed annually at the time of budget adoption; and
- Very Weak debt and contingent liability profile characterized by a large pension and other postemployment benefit (OPEB) obligation.

Environmental, social, and governance

We view the city has having elevated environmental risk in the form of exposure to seismic event--the San Andreas Fault runs just west of the city--and, longer term, from sea level rise associated with climate change. The city has undertaken an inventory of "soft story" architectural designs, which experts believe are particularly vulnerable in earthquakes, to focus response resources in a natural disaster scenario.

The city is managing chronic physical risks, such as sea level rise, on its largely commercial eastern shores by requiring resiliency designs in development projects and pursuing grant funding. Management reports that seawalls now protect most of the city's service area from estimated exposure in the 21st century.

We view the city's social and governance risks neutral within our credit analysis. The city has prioritized housing affordability challenges, which we view as a social capital risk that can threaten economic performance. Solutions include income-tested affordable housing development as a way of slowing gentrification in a high-cost region. The city manages cybersecurity risk, a form of governance risk, by using cloud-based services and backups for resiliency, adopting an information technology master plan to minimize the risk of obsolescence, and making the information technology management a senior position.

Stable Outlook

Downside scenario

We could lower the rating if budgetary performance were to significantly weaken, leading to material and sustained draws that cause reserves to fall to a level below that outlined in the formal fund balance policy or out of alignment with the city's goal of maintaining at least two months of operating revenue.

Credit Opinion

Industrial community anchored by the life sciences and biotechnology industry

South San Francisco, located five miles south of the city limits of its larger namesake, encompasses an established service area. The economic mix of the city, which was once a steel town, primarily consists of neighborhoods that have good rail and highway access to regional job centers, logistics, and lodging services associated with nearby San Francisco International Airport (SFO) and a life sciences cluster anchored by Genentech. The city has continued to see significant economic development activities throughout the pandemic, including a new Mercedes Benz dealership, Safeway, Kilroy Oyster Point, Gateway Business Park, Southline, Caltrain Station, and the continued expansion of Genentech. Genentech recently requested planning approval to almost double its 4.7 million square feet of office and research space, and management has noted another three sites at different stages of the entitlement process that would add a total 6.2 million of similarly utilized space in the coming years. This commercial development, plus continuing volume growth at SFO, has attracted hotel and residential developers, with management calculating a pipeline of about 750 hotel rooms and 3,650 housing units. We think activity at SFO, which had a particularly high proportion of business and international travelers relative to that of U.S. peers, will be slow to bounce back even with higher vaccination rates and relaxed public health rules. However, management reports that hotel sites within its boundaries have remained open and have adjusted hotel rates to contend with lower occupancy rates. Some hotels have also used the pandemic to renovate facilities.

Strong management with good financial policies and practices, including restoration of a formal long-term financial planning practice

Key policies and practices include:

- Sophisticated budget-building methodology, with an extensive analytical budget message explaining management's recommendations and assumptions relative to the prior and current budget year;
- Six-month financial updates presented to the council to allow for midyear adjustments and set the stage for the next year's budget-building process;
- Formal long-term 10-year financial plan that is updated at least annually;
- Capital planning with a five-year horizon and detail on timing and funding sources that the city updates annually;
- Investments that are governed by a comprehensive formal policy and what is now a quarterly reporting interval to the council on performance and holdings;

- Principle-based debt management policy that lacks material numerical constraints other than a minimum refunding savings threshold; and
- Formal reserve policies for several funds and purposes, including the budgeting of 2% of general fund revenue as a reserve for emergencies such as natural disasters and 7% for economic events affecting revenue, such as the loss of a major taxpayer, and an informal additional two months' revenue minimum.

Strong budgetary performance results despite negative total government fund results in fiscal 2021

South San Francisco has a strong budgetary performance profile, finishing the past three audited fiscal years with positive operating results in the general fund but finishing fiscal 2021 with a total government funds deficit of $39.9 million, or about 19% of total governmental funds expenditures. The total governmental funds negative operating result was as the result of the pandemic's affecting core revenue streams and planned capital outlay expenditures. In fiscal 2021, the general fund primarily consisted of property taxes (33%), followed by sales and use taxes (26%) and licenses and permits (13%). Although management continues to update revenue projections as information becomes available, the COVID-19 pandemic has had a direct financial effect on the city with some revenue sources yet to return to pre-pandemic levels. Revenue sources, such as its transient occupancy taxes, recognized declines of about 51% beginning in 2020.

Based on the city's revised fiscal 2022 budget, the city is expected to finish fiscal 2022 with a general fund deficit of about $6.0 million or 5% of budgeted general fund expenditures. We believe the city will finish near balanced operations given management's conservative 10-year forecast model assumptions which assumes core revenue streams will grow by a modest 2% to 3%.

To capture a clearer picture of routine governmental fund operations, we have adjusted general fund expenditures to support ongoing general fund transfers that support operations-and-maintenance in other funds.

Our calculation of available fund balance combines the assigned and unassigned portions of the general fund balance. Assigned and unassigned reserves were 43.2% of general fund expenditures, or $47 million, in fiscal 2021. We anticipate that liquidity will remain very strong and reserves strong in the near term, as the city has historically exceeded its formal 2% of general fund budgeted revenue as emergency reserve (natural disasters) and 7% of revenue for risk of loss of a major taxpayer.

Very Weak debt and contingent liability profile with no immediate additional debt plans

Following this issuance, management doesn't anticipate the city issuing additional debt for the foreseeable future. The city has issued private placement debt in the amount of $19.6 million related to its community facilities district, which is associated with the Oyster Point development project. After reviewing the legal documents, we do not consider bond provisions to have non-remote events of default, but acceleration is not explicitly included as a remedy. We note that the city's voter-approved Measure W sales tax revenue has been identified as the source of debt service for the series 2022A (and previously issued series 2020A and 2021A) to minimize the risk of strain on the general fund; even after diminishment during the recession, these legally unrestricted resources represent about 1.7x annual debt service on all three series combined.

Large pension and other postemployment benefits obligations could pressure budgets and hurt financial performance over the longer term

In our opinion, a credit weakness is South San Francisco's large pension and OPEB obligation, without a plan in place that we think will sufficiently address the obligation. The city has taken steps in recent years to manage these costs, including designating $5.5 million in its general fund balance as a stabilization reserve and exploring the option to issue pension obligation bonds. We think statewide changes to pension benefits for new hires in 2013 and the city's shift to a defined contribution from a defined benefit health benefit for new hires starting April 2010 will slow cost growth. At the same time, we consider actions to date unlikely to substantially lower pension and OPEB carrying charges, which likely will rise this decade.

The city participates in the following plans:

- California Public Employees' Retirement System (CalPERS) agent multiple-employer plan for safety employees: $118 million in net liability and 67% funded
- CalPERS agent multiple-employer plan for miscellaneous employees: $87 million in net liability and 66% funded
- Single-employer OPEB plan: $64 million in net liability, and 28% funded

For more information on our view of California pensions, see "Pension Spotlight: California," published July 13, 2021.

Strong institutional framework

The institutional framework score for California municipalities required to submit a federal single audit is strong. The city is subject to the federal single-audit requirement because it receives federal awards across at least two programs that collectively exceed $750,000 annually. These two conditions trigger enhanced financial reporting requirements under state law.

South San Francisco Key Credit Metrics

	Most recent	Historical information		
		2021	2020	2019
Very strong economy				
Projected per capita EBI as % of U.S.	135			
Market value per capita ($)	355,609			
Population			69,322	69,683
County unemployment rate (%)			6.9	
Market value ($000s)	24,651,559	23,201,747	20,932,201	
Ten largest taxpayers as % of taxable value	27			
Strong budgetary performance				
Operating fund result as % of expenditures		4.8	10.0	25.0
Total governmental funds result as % of expenditures		(19.4)	15.6	33.8
Very strong budgetary flexibility				
Available reserves as % of operating expenditures		43.2	45.5	42.1
Total available reserves ($000s)		47,028	49,018	43,121

South San Francisco Key Credit Metrics (cont.)				
	Most recent	**Historical information**		
		2021	**2020**	**2019**
Very strong liquidity				
Total government cash as % of governmental funds expenditures		126	162	159
Total government cash as % of governmental funds debt service		7,901	12,668	6,397
Strong management				
Financial management assessment	Good			
Very weak debt and long-term liabilities				
Debt service as % of governmental funds expenditures		1.6	1.3	2.5
Net direct debt as % of governmental funds revenue	135			
Overall net debt as % of market value	2.1			
Direct debt 10-year amortization (%)	42			
Required pension contribution as % of governmental funds expenditures		10.2		
OPEB actual contribution as % of governmental funds expenditures		2.3		
Strong institutional framework				

Note: Data points and ratios may reflect analytical adjustments. EBI--Effective buying income. OPEB--Other postemployment benefits.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022
- 2021 Update Of Institutional Framework For U.S. Local Governments